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The Secretary of the Treasury

October 15, 1984

18 OCT 1984

NOTE FOR BILL CASEY:

On August 16, I distributed a briefing book on key domestic and international economic issues. Enclosed is an updated version of that briefing book that reflects the most recent economic data and trends. This update replaces the previous version in its entirety.

I hope this is helpful in the coming weeks. Let me know if you have any additional questions you would like addressed.

DTR

Donald T. Regan

DCI EXEC REG

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ECONOMIC AND RELATED ISSUES FOR CABINET OFFICERS' USE

October 15, 1984

L-309

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I. ECONOMIC POLICY

INTEREST RATES

Q: Why are interest rates so high? Why are they rising? What are you going to do about them?

A: Interest rates are determined by a number of factors. The booming economy has produced a demand for funds, as people have the renewed confidence and incentives to modernize factories, expand businesses and buy homes.

Interest rates are also being held up by uncertainty and fear of rising inflation in the future. However, the apparent inflation factor in current interest rates seems to be several percentage points above the rate of inflation.

It will take time for the American public, which has been so badly soured by inflation, to fully understand that this Administration will never allow the resurgence of inflation.

We have asked the Federal Reserve to supply enough money and credit to the system to fully support non-inflationary growth. We want them to continue to do that.

While interest rates in general rose during the first five months of the year and the prime rate is at 12-3/4 percent at most banks, long-term rates have trended down nearly 1-3/4 percentage points since May. We expect this trend to continue. Short-term rates continued to rise through August, but were down slightly in September.

- -- The drop in long-term rates reflects confidence that this Administration is serious about containing inflation.
- -- State and local surpluses have been improved by the recovery.
- -- The budget deficit in 1984 will be more than $20 billion less than in 1983.
- -- The economy is definitely showing slower growth rates following the strong snap-back from the recession.
- -- The recent slow growth of money has left M1 below the midpoint of the Fed's target range, giving the Fed ample room to maneuver.

All these factors tend to raise the supply or lower the demand for credit, and point to lower interest rates.

MONEY SUPPLY

Q: Is the money supply too tight as some have claimed?

A: Officials at the Fed are the closest to the day-to-day shifts in money supply and they are most able to answer that. All we have asked is that the Federal Reserve continue to provide enough money growth so that we can have sustainable, non-inflationary growth. They have repeatedly stated their intention to do this and we fully support that goal.

In the last few weeks, money growth has slowed to very low levels, about 2 percent on a 13-week basis. Since the start of the 4 percent to 8 percent M1 target growth range last fall, M1 has grown at about a 5 percent annual rate.

Inflation continues under control. The producer price index has risen only 1.6 percent over the past 12 months. The consumer price index has been well behaved, rising at only a 4.2 percent rate in the first eight months of 1984 compared to December-to-December increases of less than 4 percent in 1982 and 1983, down from 13.3 percent in 1979, 12.4 percent in 1980 and 8.1 percent in 1981.

The sharp run-up in the dollar on the foreign exchange markets, continued strength in short-term interest rates, and easing commodity prices could be indicating that money is in short supply. Slower GNP growth has been confirmed by a wide range of statistics. These point to the possibility that monetary policy may need to ease somewhat in the months ahead.

MISERY INDEX

Q: Critics claim the "Reagan-induced recession" raised the national misery index. Is this true?

A: The dramatic reduction in the misery index -- the combination of inflation as measured by the Consumer Price Index and the unemployment rate -- from 19.5 in 1980 to 11.8 in the first half of 1984 -- refutes this claim. The misery index has fallen in every year of the Reagan Administration. By contrast the misery index rose every year of the Carter-Mondale Administration, from 12.5 in 1976 to 17.5 in 1980. (See Chart 1.)

Inflation, which was raging at double-digit levels in 1979 and 1980, has been reduced to 4.1 percent (annual rate) in the first half of 1984. Over the past three months the CPI is up only 3.7 percent.

Since the recession ended in November 1982, over 6 million Americans have found jobs, with over 105 million people at work.

Chart 1

Note: For each year the index is the percent change in the CPI-U on a December to December basis plus the average unemployment rate for the year. 1984 is based on data for the first half of the year.

August 7, 1984 A10a

REAL WAGES

Q: Mondale has charged that workers are worse off than they were four years ago.

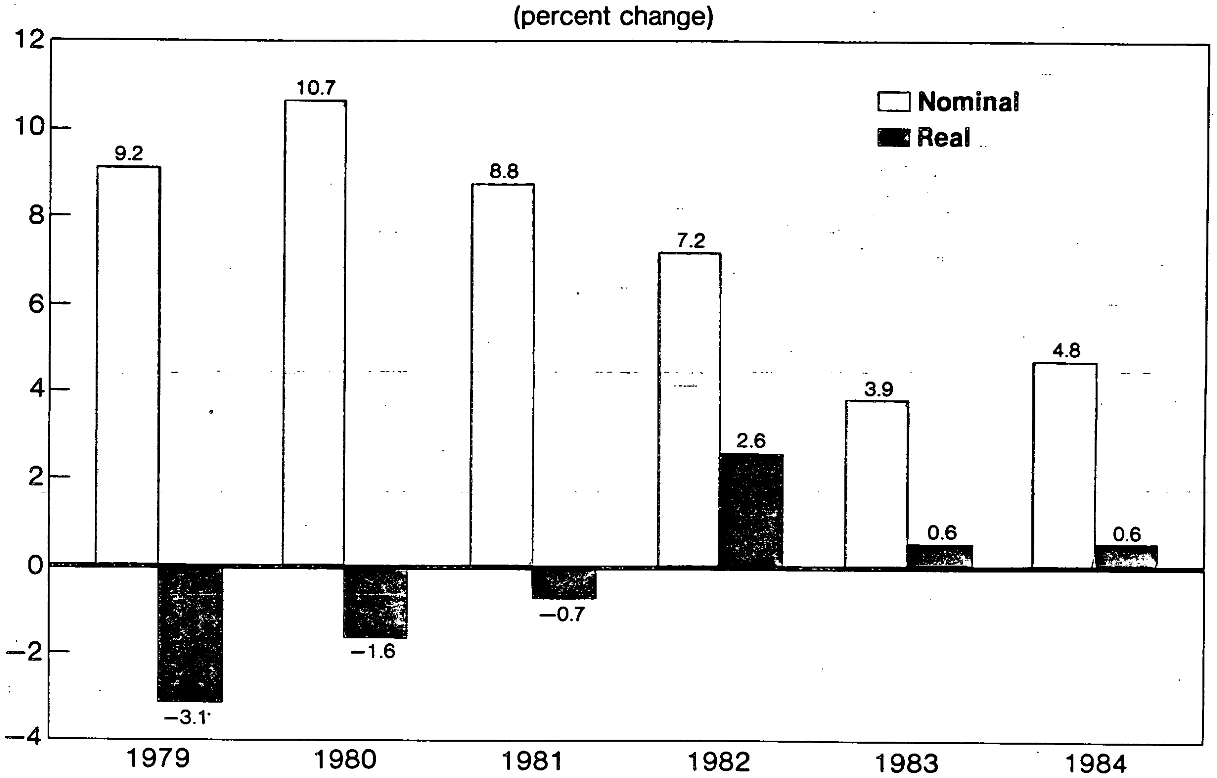
A: Not true. Real wages per hour have risen under Reagan. (See Chart 2.) In 1980 the economy was in its second year of high inflation and falling living standards. The consumer price index rose 13.3 percent in 1979 (December-to-December) and 12.4 percent in 1980. Wages failed to keep pace. Real compensation in the private non-farm business sector (wages plus fringes) fell sharply in 1979 and 1980. The drop in compensation was much greater on an after-tax basis as inflation raised tax rates. By 1982, inflation had fallen to 3.9 percent, and to 3.8 percent in 1983. Wages grew more slowly in nominal terms, but faster than prices. Real compensation rose in 1982, 1983 and so far in 1984. Real wage growth is substantially stronger on an after-tax basis, thanks to President Reagan's determined efforts to retain the tax reductions for individuals enacted in 1981. (See Table 1.)

We have made remarkable progress in raising real growth and real incomes while bringing inflation under control.

Chart 2

GROWTH OF NOMINAL AND REAL COMPENSATION IN THE PRIVATE NONFARM BUSINESS SECTOR

(percent change)



Note: Measured fourth quarter to fourth quarter.
1984 is the annual rate for 1st half of the year.

August 6, 1984-A33

TABLE 1

TAXES, INFLATION AND INCOME

Because of the recent drop in inflation and federal tax cuts, the purchasing power of the American family has begun to rise again.

According to an analysis by the Tax Foundation, a family with one full-time wage earner with two dependent children has 5.6 percent more to spend this year than it did in 1981.

Measured in constant 1974 dollars, the family's real income has risen by $539 in the past three years, according to the organization. Still, the family's real after-tax income is still lower than it was 10 years ago. Measured in 1974 dollars, the family's purchasing power has been cut by $801, or 7.3 percent, over the past 10 years.

		DIRECT FEDERAL TAXES			AFTER-TAX INCOME	
Year	Median Family Income[1]	Income Tax[2]	Social Security	Total	Current Dollars	1974 Dollars[3]
1974	$13,004	$1,267	$761	$2,028	$10,976	$10,976
1975	14,156	1,172	825	1,997	12,159	11,145
1976	15,016	1,388	878	2,266	12,750	11,049
1977	15,949	1,466	933	2,399	13,550	11,025
1978	17,318	1,717	1,048	2,765	14,553	11,000
1979	19,048	1,881	1,168	3,049	15,999	10,869
1980	20,586	2,143	1,262	3,405	17,181	10,282
1981	21,462	2,267	1,427	3,694	17,768	9,636
1982	23,036	2,342	1,543	3,885	19,151	9,786
1983*	24,140	2,296	1,617	3,913	20,227	10,013
1984*	25,700	2,428	1,722	4,150	21,550	10,175

[1] Median income for all families with one earner employed full-time, year-round
[2] Married couple filing joint return, two dependent children
[3] Adjusted by Consumer Price Index
*Estimated by Tax Foundation

SOURCE: Census Bureau, Bureau of Labor Statistics, Internal Revenue Service, and Tax Foundation computations

The Washington Post

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BALANCED BUDGET

Q: The critics of the Administration claim they can and will reduce budget deficits and "restore sanity to our fiscal house." Do you agree with the statement?

A. Despite their rhetoric on fiscal responsibility, the only suggestions for deficit reduction have been lower defense spending and higher taxes. Despite the rhetoric on the dangers of deficits, they are opposed to a balanced budget amendment, and resist the line-item veto. Despite the rhetoric about a fair tax system, they want to defer tax indexing, which would result in massive tax increases on working Americans.

A recent budget proposed in April 1984 (which was rejected by a 76-333 vote) would have cut defense spending by $203 billion, increased taxes by $181 billion over three years, and increased domestic spending by $99 billion. The tax increases contemplated under this budget <u>included a repeal of tax indexing, three-fourths of which would hit workers earning under $50,000,</u> and a repeal of the estate and gift tax reductions enacted under the President's tax cuts.

Congress has not given Ronald Reagan one budget that he has proposed. If the President's budget and down-payment plans are enacted, by 1989 the deficit as a percentage of GNP will range from 2-3 percent -- roughly where it was in the period 1975-80. In addition, what deficit does remain will be offset by state and local government surpluses.

DEFICITS

Q: Those who say they are committed to reducing the deficits say that the Administration acts as if deficits do not count. They claim the President is opposed to serious efforts to reduce the deficit. How do you respond to this charge?

A: The Administration believes strongly that the federal budget must be balanced, and it is committed to find ways to reduce the growth of federal spending and put the budget on a path that will eliminate deficits and produce a balanced budget. In fact, the budget would be much closer to balance if the Congress had enacted all of the spending cuts President Reagan has proposed since coming to office.

Apparently the Congress lacks the will to reduce government spending. The President just recently again asked them to pass a constitutional amendment requiring a balanced federal budget.

We have also asked for the line-item veto which would allow the President to sharply reduce spending.

President Reagan's concern about budget deficits is nothing new. In August of 1973, he remarked, "When an individual or a business has a lean year, they have to prune expenses and work for better days. When the [Democratically-controlled] government has a deficit, it expects to solve that deficit by handing you a higher tax bill."

DEFICITS

Q: Political opponents claim that the large budget deficits were caused by "the huge tax cuts to benefit the wealthy and an enormous military build-up." Do you agree with this statement?

A: Contrary to these claims, the deficits are not high because the American people are paying too little in taxes. Deficits are high because Congress continues to spend too much of the taxpayers' money.

It is sometimes argued by advocates of big government that the Reagan tax cuts were too large. In fact, the tax cuts were barely large enough to offset ongoing tax increases. If the previous tax code had been allowed to remain in place, Federal tax receipts would have kept on soaring. They would have been close to 25 percent of GNP by FY-1989 -- a level without precedent in U.S. peacetime experience.

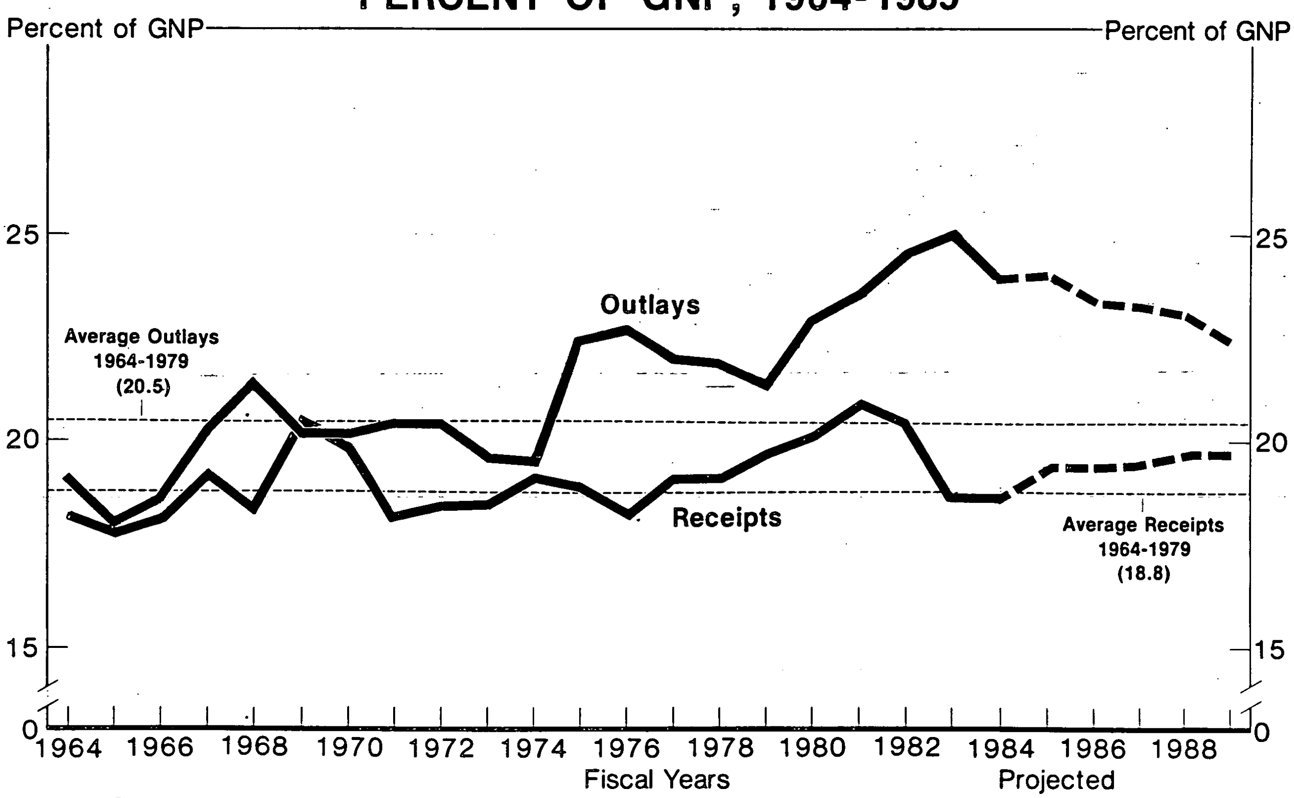
Federal budget receipts were 18.6 percent of GNP in FY-1983 and are projected to be 18.8 percent of GNP in FY-1984. Average receipts over the period 1964-1979 were also 18.8 percent of GNP. The future budgetary problem does not arise because the American people are undertaxed. Quite the contrary, under existing law Federal tax receipts will average 19.5 percent of GNP over the period 1985-89. Receipts will be 19.7 percent of GNP in 1989, nearly a full percentage point above the tax levels that were considered normal before the 1980s. (See Chart 3.)

Outlays are even further above their historical levels. Between 1964 and 1979, outlays averaged 20.5 percent of GNP. The recessions of 1980 and 1981-82 have slowed GNP growth and driven outlays to 23.9 percent of GNP in 1984. They will still be above 22 percent of GNP by 1989 without further restraint on the growth of spending or faster-than-projected economic growth. Most of the total outlays now being projected for the future are in areas that many now seem to regard as somehow untouchable. That psychology must change if we are ever going to bring Federal outlays under control. In fact, if budget outlays could grow slightly more slowly, perhaps about half as fast in real terms as real GNP, the budget could be well on the way to being balanced by 1989. The same result could be obtained by having GNP grow more rapidly, or some combination of the two.

Most of the growth of outlays has come from higher domestic spending. While spending on national defense has increased from the wholly inadequate levels of the Carter-Mondale Administration, defense spending as a percent of GNP is at lower levels than it was in either 1960 or 1970. In 1984, defense spending was at 6.7 percent of GNP, an increase from the 5.2 percent level it was at in 1980. However, defense spending was at 9.7 percent in 1960 and 8.4 percent in 1970.

Chart 3

OUTLAYS AND RECEIPTS AS PERCENT OF GNP, 1964-1989



Note: Outlays include off-budget federal entities.

August 15, 1984-A313

FAIRNESS

Q: There are those who claim the Reagan tax program gave huge tax breaks to the wealthy and they promise the rich will be forced to shoulder a greater share of the new tax burdens. What is your response to these critics?

A: The President's tax cut was progressive and fair, with all tax rates reduced by the same percentage across-the-board. The bulk of the President's tax cut went to those who pay most of the taxes -- middle-income taxpayers. Nearly two-thirds of the tax cut went to low- and middle-income taxpayers earning less than $50,000 a year.

In fact, those earning less than $50,000 now pay a smaller percentage of total income taxes than they did in 1980; and those earning more than $50,000 pay a larger percentage of total income taxes than they did in 1980.

The income tax system is fairer now than it was under the Carter-Mondale Administration.

SPENDING

Q: The Democrats claim they will control domestic spending, and they pledge to deal with the growing costs of domestic programs. How can they meet those goals?

A: While giving lip service to restraining nondefense spending programs, Democrats have promised increased spending for program after program. The Wall Street Journal reported earlier this year that Walter Mondale's campaign promises could cost the taxpayer as much as $150 billion or more. The inability of the Democrats to change their decades-old spending behavior makes a mockery of their pledge to reduce deficits.

SOCIAL SECURITY

Q: Mr. Mondale has charged that the Reagan Administration has savaged social security. Please respond.

A: This simply is not true. (See Fact Sheet 1.) The number of OASDI beneficiaries has increased by almost 3 percent between 1980 and 1984 and the number of Medicare enrollees has increased by 7.4 percent.

The only meaningful way to compare dollar amounts over time is to adjust for inflation so that real growth (or decline) can be measured. Total OASDI benefits have grown by 16.6 percent in real terms between 1980 and 1984. The average real benefit received by retired workers has grown by 19.2 percent.

The real increase in Medicare benefits is even more dramatic. Per capita health insurance benefits have grown by 34.1 percent in real terms, and expenditures for Part B of Medicare (Supplementary Medical Insurance-SMI) have grown by 58.7 percent in real terms. Moreover, the share of SMI expenses being borne by the federal government as opposed to premiums for participants has increased from 68.6 percent in 1980 to 74.3 percent in 1984. According to a study by the Health Care Financing Administration, in 1984 Medicare will pay 49 percent of all medical expenses for the elderly as compared to 44 percent in 1977.

Fact Sheet 1

Program	1980	1984	Growth
OASDI: Total (retired workers, survivors, disabled)			
Beneficiaries (in thousands)	35,119	36,133	2.9 %
Benefits (in $ billions)	120.6	176.7	46.5
Inflation Adjusted Growth			16.6
OASDI: Retired Workers			
Beneficiaries (in thousands)	19,064	21,544	13.0
Avg. Benefit as of March 31	295.3	442.0	49.7
Inflation Adjusted Growth			19.2
MEDICARE: Hospital Insurance			
HI Enrollees (in thousands)	27,683	29,741	7.4
HI Benefits (in $ billions)	25.1	45.3	80.9
Average HI Benefit ($ real)	905.4	1524.7	68.4
Inflation Adjusted Growth			34.1
MEDICARE: Supplementary Medical Insurance			
SMI Benefits ($ billions)	10.6	21.2	99.4
Inflation Adjusted Growth			58.7
Federal Government Share of Contributions (in percent)	68.6	74.3	8.4 %

POVERTY

Q: Can you comment about the poverty situation in the U.S.?

A: A 1983 poverty study by the Commerce Department shows that poverty was contained in 1983 in spite of the lingering effects of recession, and that poverty must be falling in 1984.

The poverty rate inched up to 15.2 percent in 1983 compared to 15 percent in 1982, which is within the margin of error of the survey and is not necessarily a real change. But the real point to note is that early 1983 was almost at the trough of the 1981-1982 recession. The 1983 average contains some very depressed months. The poverty rate was surely falling over the year as the economy experienced rapid growth. The poverty rate is surely lower in 1984 than in 1983.

In 1982, the poverty rate reflected an economy moving deeper into recession. In 1983, virtually the same poverty rate occurred, but the economy was moving out of recession. Thus, although the rates are similar, the poverty situation was much more hopeful, and the future much brighter, in 1983 than in 1982.

A far more relevant set of statistics is that real inflation-adjusted median family income rose 1.6 percent from 1982 to 1983, and rose even more after taxes thanks to the Reagan tax cuts. Furthermore, the growing economy has increased employment by more than six million since the end of 1982.

BALANCED BUDGET AMENDMENT AND LINE-ITEM VETO

Q: Would you comment, please, on the President's position on the balanced budget amendment and the line-item veto?

A: President Reagan called on Congress to take action on the Constitutional amendment to balance the budget as recently as July 24 at his televised press conference, saying "we must balance [the budget] not by raising the tax rates of hard-working Americans, but by insisting that government spend no more than it takes in." The Democratically-controlled Congress left Washington for their August recess without considering this vital legislation.

In his State of the Union Address in January, President Reagan asked Congress to give him the same authority that the governors of 43 states currently have -- the line-item veto. Presidents since Truman have made the same request.

As the Wall Street Journal pointed out in an August 16 editorial, "The U.S. President, by contrast [to the 43 governors who have this authority], must veto an entire multibillion dollar appropriation bill, killing the good with the bad."

The Wall Street Journal, in endorsing the line-item veto as a useful tool to control government spending and reduce the federal deficit, put these hypothetical words in President Reagan's mouth: "Congress has forgotten how to say "no" to people. ...The only reason the budget is uncontrollable is that Congress made it that way." The editorial further points out that 67 percent of the people in the United States support a presidential line-item veto, according to a Gallup Poll conducted last November.

President Reagan has always believed in responsible government. Speaking in October of 1973 he said, "We derive our ultimate authority from the people. And we have an obligation to make sure that in carrying out our responsibilities, we do so at a price they can afford."

II. TAXES

RAISING TAXES

Q: In his acceptance speech Mr. Mondale said, "Let's tell the truth. Mr. Reagan will raise taxes and so will I. He won't tell you. I just did." Would you please comment?

A: Mr. Mondale's statement is either uninformed or untrue - possibly both. The President's position is clear. He has stated he has no plans for a tax increase in 1985 or beyond.

Specifically, the President said "I will use the power and authority of the office of President to continue strong economic growth, eliminate wasteful government spending, and reduce the size of government, as the means to reduce the deficit. As I said at my last press conference, after (and only after) wasteful government spending has been reduced to its absolute minimum would I consider raising taxes to eliminate any gap between revenues and expenditures. Even then, I would not consider raising the personal income taxes of working Americans."

The contrast could not be sharper. Mr. Mondale -- who has spent his entire political life supporting more taxes and more spending -- has put the American public on notice that nothing will change. He will, as a first resort, raise your taxes. The President, who has fought his entire political life as an opponent of higher taxes, would consider tax increases only as a last resort.

TAX BURDEN

Q: The Democrats claim that a second Reagan term would result in an increasing tax burden on the average American. Is this true?

A: Unlike the Democrats, we categorically reject the notion of increasing taxes on the working people of this country in order to reduce deficits. Rather than reducing deficits, tax increases would reduce incentives for economic growth, retard the economic expansion, and simply give Congress more money to spend.

The best way to cure the out-year budget deficit problem is to increase economic growth and to cut the growth of spending. And rather than raising taxes on working people, which is what the Democrats are calling for with their pledge to defer tax indexing, a second Reagan term will simplify and reform the present tax system to make it fairer, with a broader tax base and lower tax rates.

PERSONAL EXEMPTION

Q: About a month ago there were widespread rumors that the Administration might seek a doubling of the personal exemption under the income tax. Is that something the Administration expects to ask the Congress to do next year?

A: I do not know what the Treasury Department will recommend in its December report on Fundamental Tax Reform, and it would be premature and inappropriate for me to attempt to guess or announce any decisions. But I can tell you that the Secretary of the Treasury has said that fairness toward families should be one of the principles guiding its analysis of tax reform.

The Administration is quite concerned about the deterioration in the real value of the personal exemption. Indexing will prevent inflation from ever again eroding the value of exemptions.

TAX REFORM

Q: Can you give us some idea of what the Administration's tax reform proposal may look like in 1985?

A: The Treasury Department is examining all possible options, including a flat tax; a consumption tax; a broader-based, lower-rate income tax; and a value-added tax. It would be inappropriate for me to assume or attempt to guess the results of that study.

Nonetheless, whether one is talking about a flat tax, a personal consumption tax or a broader-based, lower-rate income tax, there are some issues that must be addressed under almost any proposal.

Tax rates should be kept as low as possible. The tax system should be neutral with respect to most private decision-making. It should not favor one industry over another or place one type of business at a disadvantage relative to another. It should not direct consumption patterns of individuals. It should be fair. It should be administrable.

Among other things, these requirements imply that the tax system cannot be glutted with so many credits, exclusions and deductions that it is costly to administer, cumbersome to enforce, and incapable of being understood.

The Presidentially directed guidelines of fairness, simplicity and efficiency will produce a system that is much better than the current system.

One further point. This tax reform study is <u>not</u> designed to hide a tax increase. It is going to produce recommendations that are revenue neutral. Revenues gained from closing tax shelters and loopholes are to be used to lower tax rates for all taxpayers.

FAIR TAX POLICY

Q: Tax policy is already a major campaign issue. President Reagan claims that his tax policies are fair and that he won't raise taxes if he is re-elected. But Walter Mondale has suggested that raising taxes or deferring indexing may be necessary. What's really going to happen to taxes if Ronald Reagan is re-elected?

A: What's fair about pushing taxpayers into higher tax brackets by repealing indexing? The only way to increase tax revenue by repealing indexing is through inflation. The American people have already spoken loud and clear on that subject.

Mr. Mondale has already told us he plans to raise taxes. President Reagan has told us he has no plans to do so. President Reagan has told us that he wants your tax cut to be permanent. Mr. Mondale wants to take it back. What's fair about that?

President Reagan wants Congress to vote before it raises your taxes. Mr. Mondale, by advocating partial repeal of indexing, wants hidden automatic tax increases without a single recorded vote. What's fair about that?

President Reagan's tax program has had the intended, fair, result. It has gotten taxpayers' tax burden down and will keep it down. That program, coupled with spending cuts and deficit reduction, will enable American taxpayers to keep the money they earn by working hard and permit them to spend it for their own private purposes instead of turning it over to the federal government to pay for public programs.

In addition, growth alone will bring in about $70-90 billion more in revenues each year from 1985-1989. This will provide nearly $400 billion more by 1989 than in 1984. Revenues will amount to more than one trillion dollars. Isn't that more than enough to spend annually? Couldn't we save some of this and apply it towards cutting the deficit?

UPPER INCOME TAXES

Q: Mr. Mondale has proposed caping the Reagan tax cut -- which is, in effect, a tax increase, for married couples making over $60,000 a year, and single people making over $45,000. Do you think that is advisable?

A: I do not think it would be advisable. The Reagan personal income tax cut was fair -- a 25% tax-rate cut for everyone. No American should be singled out for punitively high taxes. Every American ought to know that should he work harder or longer or be more creative or innovative, he can keep most of the rewards that come from his efforts.

Higher marginal rates have adverse effects on the economy. For example, when the top tax rate was 70 percent, taxpayers saved less, consumed more, increased the use of tax shelters, and paid less tax. Today, at a top tax rate of 50 percent, taxpayers have more incentive to earn taxable income, and they're paying a bigger share of total taxes.

Mr. Mondale's plan simply proposes bringing back the disincentives to working, saving, investment, and the earning of taxable income.

TAX CUTS AND DEFICITS

Q: Mondale has charged that the deficit is due in large part to the tax cuts. Please comment.

A: Not so. The tax cuts were largely needed to offset inflation-induced bracket creep and scheduled Social Security increases. (See Chart 4.)

Our tax cuts have held taxes even, both in the aggregate as a percent of GNP and on a per-family basis as a share of income.

Almost half of the current deficit is due to the lingering effects of the recession. That and overspending by government are the sources of the deficit. <u>Economic growth</u> and <u>spending restraint</u> are the answers.

INDEXING

Q: Mondale has suggested repealing tax indexing while protecting lower income workers. Can this be done?

A: Yes, but the biggest victims of inflation and bracket creep are middle-income taxpayers. Their tax burden rises faster with inflation than those of upper-income taxpayers. Fairness demands that we keep full tax indexing.

In 1981 the House Democratic leadership wanted a two year tax cut and no indexing. The President wanted a three year tax cut and inflation protection.

It was actually a Democratic Amendment (the Brodhead Amendment) in the House that dropped the top tax rate from 70 percent to 50 percent. The Democratic leadership hoped this would buy off the President and the House Republicans from their insistence on a third year of tax cuts and indexing. But the President, House Republicans and conservative Democrats insisted on the third year of the tax cut for lower and middle income families, and on tax indexing to keep inflation from taking the tax cuts back. (See Chart 5.)

Keeping Taxes Down

$15,000 Wages

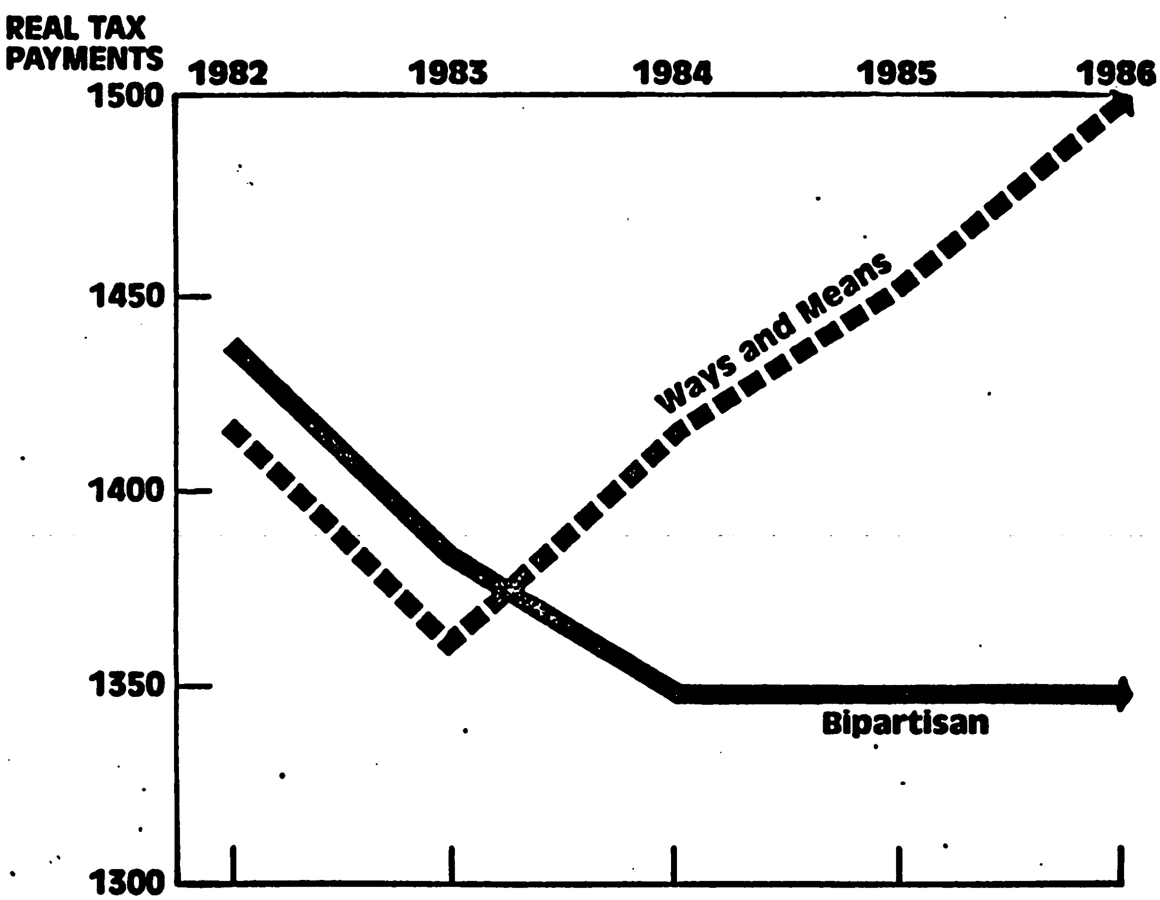
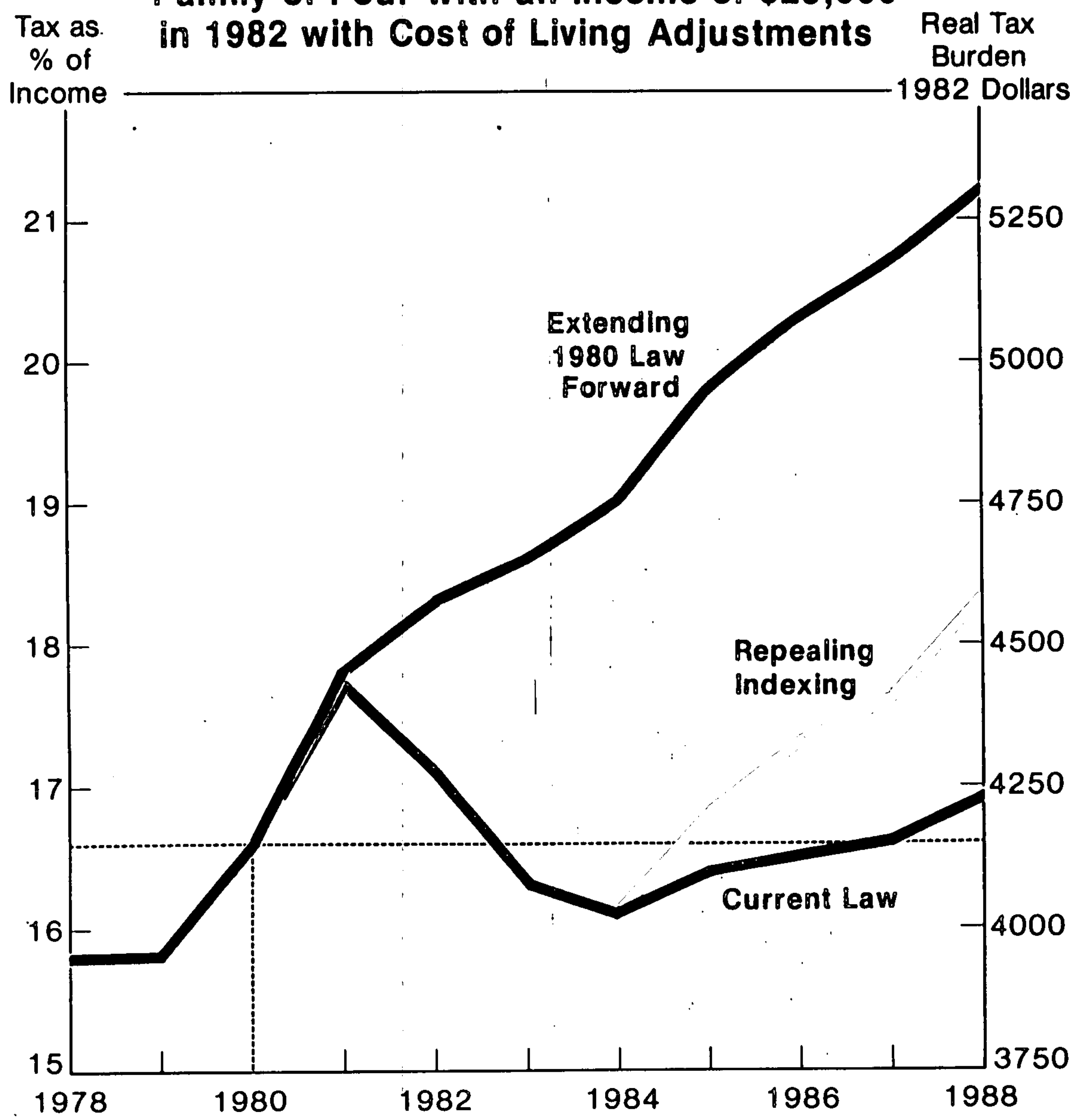


Chart 4

REAL TAX BURDEN (INCOME & EMPLOYEE PAYROLL TAX)

Family of Four with an Income of $25,000 in 1982 with Cost of Living Adjustments



January 25, 1984 A47

THE UNDERGROUND ECONOMY

Q: This Administration boasts a reputation for tough "law and order" policies, yet the underground economy thrives, with millions of Americans evading their tax obligations. Would you comment, please?

A: According to the IRS, about $87 billion goes uncollected each year. That figure represents the tax on $300 billion of unreported income, and that figure excludes income from illegal activities. The Reagan Administration has tackled this problem head-on on a number of fronts:

-- President Reagan has charged the Treasury Department to recommend a simple, fair, and economically efficient system that will redress some of these problems. That report is due in the Oval Office in December.

-- President Reagan's tax package included much tougher compliance provisions.

-- We're using the newly emerging technology to bring tax-processing up to date. Twenty-year-old computers are being replaced by state of the art equipment that is more economical and more efficient.

-- We've developed some simpler and more helpful tools for helping taxpayers. One out of four taxpayers used the new 1040EZ form. And we're finding more efficient ways of assisting and informing taxpayers.

President Reagan respects the hard work of those Americans who pay their taxes conscientiously. This Administration will not permit scofflaws to cheat their fellow Americans by failing to carry a fair share of the tax burden.

III. INTERNATIONAL

ARGENTINE DEBT

Q: What are the implications of the agreement in principle which Argentina has reached with the IMF? What is the next step? Where do negotiations with creditor banks stand?

A: The preliminary agreement which Argentina reached with the IMF on September 25 paves the way for the adoption of a comprehensive IMF-supported adjustment program. Implementation of such a program would lead to the restoration of sustainable economic growth in Argentina. The next step involves negotiations with creditor banks on a "critical mass" of bank financing which the IMF Managing Director requires before submitting the program to the IMF Board for approval. Negotiations with the banks began on September 26. In view of the number of issues involved, it is difficult to estimate when these negotiations will be concluded.

LDC DEBT

Q: How threatening to the United States is the LDC debt situation?

A: We do not see the LDC debt problem as a major threat to the United States or to the international financial system.

Our basic five-point strategy for improving the creditworthiness of these indebted countries was agreed to by the participants at the Williamsburg and London Summits.

It depends very much on comprehensive, credible and effective adjustment programs by the debtors; continued economic growth in industrial countries; adequate IMF resources; continued commercial bank lending to those making determined adjustment efforts; and bridge financing on a selective basis when appropriate.

It emphasizes the case-by-case approach so as to be able to tailor responses to the specific conditions of each debtor country.

We should expect that occasionally a debtor may fall into deeper difficulties, but our strategy is flexible enough to respond to such a situation.

The process of restoring the creditworthiness of the LDCs will take time and patience; we are not out of the woods yet but the strategy is working.

STRONG DOLLAR

Q: Isn't it true that the high value of the dollar is hurting American exports and American workers? What is the Administration response?

A: The strong dollar <u>does</u> increase import competition and decrease U.S. export competitiveness. But the dollar is not the only factor affecting U.S. exports and workers. Other key factors include:

- LDC debt problems, causing major decline in key debtors' imports from <u>all</u> sources, 1981-83.
- Weakness of foreign industrial economies, hence weak demand for U.S. exports.
- Need for U.S. industries to improve productivity, adjust to efficient foreign competition.

The dollar is strong because the U.S. economy is strong relative to foreign economies.

<u>All</u> sectors of the U.S. economy, including traded goods industries, are benefitting from the U.S. recovery:

- Unemployment is falling.
- Capacity utilization and profits are rising.

The strong dollar also helps keep down inflation, and increases the U.S.'s competitive position for the future.

The only way to fundamentally "weaken" the dollar is to restore economic growth abroad. The U.S. recovery is helping to lead the way. The worldwide recovery will also increase demand for U.S. exports and give a further boost to U.S. jobs.

TRADE DEFICIT

Q: Isn't it true that the strong dollar has hurt the competitive position of U.S. industries and led to the largest ever trade deficit?

A: Of course, when the dollar appreciates it raises the price of U.S. exports to foreigners and lowers the dollar price of imports. But competitiveness is a more complex question than just that. It depends on other factors such as product quality and the prices of the goods involved themselves. I would note that, on average, U.S. prices are going up much less quickly than those of our trading partners, in part because of the strong dollar.

It is true, however, that the U.S. is recording the highest ever trade deficit -- expected to reach some $110 billion in 1984 -- but this is largely attributable to factors other than the value of the dollar.

Most importantly, the trade deficit results from the very strong expansion in our economy and, in particular, the fact that our growth is substantially faster than that of our major trading partners. (This phenomenon is especially pronounced because the U.S. trades extensively with developing countries with debt difficulties.) This cause of the trade deficit should disappear as economic recovery abroad accelerates.

Also, a large trade deficit should not be interpreted to mean trade is hurting the economy -- exports are already up significantly and the economy as a whole is booming. In this instance, the trade deficit is a sign of our relative strength, not our weakness.

TRADE DEFICIT

Q: The United States is recording its largest ever trade deficit. What does this mean for the American economy and American jobs?

A: The trade deficit is large. But it is a measure of our strength not our weakness. The rise in imports reflects the very strong pickup in our economy. The U.S. economy is growing more than twice as fast as our major trading partners.

The trade deficit also reflects the strong dollar, which stems largely from foreign confidence in the U.S. economy.

The slow recovery in Europe -- and the LDC debt situation -- is hurting our exports. As our trading partners' recoveries gather steam, U.S. exporters will see their sales pick up.

If we held the deficit down by slowing our growth rate -- or by stopping our expansion -- we would lose jobs not create them. Slower domestic growth would directly reduce new job creation. Our lower imports would reduce foreigner's ability to purchase U.S. products, indirectly reducing job opportunities.

U.S. EXPORTS

Q: Are U.S. exports decreasing?

A: No, U.S. exports are increasing. Worldwide economic recovery has increased demand for U.S. products:

-- The overall level of U.S. exports during the first eight months of 1984 increased 9.3 percent (or by $12,250 million) compared to the same period in 1983.

-- During the first six quarters of the current recovery American exports have expanded at a 6 percent annual rate compared to an average pace of 4.6 percent in the five previous expansions since the Korean War.

U.S. EXPORT MARKET SHARE

Q: Is the U.S. losing export market share?

A: No, the U.S. share of world exports has held its ground over the past 5 years:

- -- The U.S. share of total exports was 12.2 percent in 1978, and 12.4 percent in 1983.
- -- The U.S. share of world manufacturing exports was 15.0 percent in 1978, and 16.6 percent in 1983.
- -- During the first eight months of 1984, overall U.S. exports have expanded 9.3 percent compared to the same period in 1983.

THE DOLLAR, EXPORTS AND JOBS

Q: There have been allegations that the strong dollar and the resulting decrease in exports and increase in imports has cost American workers 3 million jobs and that therefore efforts should be made to bring down the dollar. How do you answer this?

A: Although the strength of the dollar has made imports more attractive to U.S. purchasers, it does not appear to have severely damaged the market for U.S. exports. During the first six quarters of the current recovery American exports have risen at a 6.0 percent annual rate compared to a 4.6 percent pace averaged in five previous post-Korean War expansions.

Furthermore, our ability to import cheaper foreign products has been one of the many factors contibuting to the dramatic slowdown of inflation in this country in recent years. It is estimated that the increase in the dollar has shaved roughly two percentage points off annual inflation in recent years.

Finally, civilian employment has risen by a huge amount -- 6.2 million workers -- since the recession trough in November 1982. As a result, the portion of the civilian noninstitutional population employed has risen to 59.5 percent -- only six-tenths of a percentage point below its all-time high -- and the civilian unemployment rate has dropped by 3.3 percentage points to 7.4 percent in September.

IV. OTHER CURRENT ISSUES

CONTINENTAL ILLINOIS BANK

Q: The critics are charging that the Reagan-led deregulation caused the problems at Continental Illinois National Bank and Trust Co. Is this true?

A: Continental Illinois' problem had nothing to do with deregulation. Its problem was simply bad domestic loans -- chiefly in energy.

The deregulation bill recently passed by the Senate (S. 2851) probably would have helped Continental. The legislation, which has not been passed by the House, would allow the bank holding company to diversify its risk.

Diversification could not have turned bad loans into good loans for Continental, but it could have supported the bank holding company and helped dilute the crisis of confidence which led to the bank's troubles.

In short, poor management and excessive regulation of the banking industry exacerbated Continental's problems, while deregulation probably would have helped.

CONTINENTAL A BAILOUT?

Q: Wasn't the rescue of Continental Illinois a bailout -- using the taxpayers' money?

A: No. It was an assistance package put together by the FDIC. The FDIC consists of an insurance fund whose premiums are paid by banks, so no taxpayers' money was involved.

BIG BANKS VERSUS SMALL BANKS

Q: Why did the FDIC offer to protect all depositors in Continental Illinois but did not pay off large depositors in smaller regional banks such as First Pennsylvania?

A: First, you should be aware that the FDIC gave assurances to all creditors in three recent smaller bank transactions, so it is not only large banks which receive assurances. In 1981, the Greenwich Savings Bank in New York was experiencing a run. The FDIC gave a similar assurance to depositors and other general creditors in order to buy time to arrange an orderly merger. The action was successful. In 1983, the FDIC provided an interim $25 million capital infusion to the United Southern Bank in Nashville and also issued an assurance to depositors. Again, the action gave FDIC the time needed to arrange an orderly merger. Finally, later in 1983, the FDIC provided interim capital of $100 million to First National Bank of Midland before putting together a merger.

Second, the FDIC did not apply its modified pay-off procedure, where depositors over the insurance limit are exposed to the risk of loss. The bank had not been declared insolvent by its primary supervisor which was a legal prerequisite to any kind of pay-off. Moreover, the modified pay-off procedure was introduced as a test, which ended before the run on Continental began. The eight out of 22 failures in which the modified pay-off was used are currently being evaluated. The FDIC has announced that it will not change its general procedures for handling bank failures without "adequate public notice and lead time."

Finally, and most importantly, small banks would have been among the principal victims because hundreds of banks maintained correspondent banking relationships with Continental. In short, the stability of the banking system would have been affected if Continental had not been stabilized.

THE BANKING SYSTEM

Q: What is the current condition of the banking system?

A: Second-quarter earnings declined at many of the country's major banks. Significant factors contributing to this earning decline were nonperforming Argentine loans and bond and foreign-exchange trading activities. Exposure to problem international loans continues to present a concern to many major banking companies, and provisions for loan losses remain fairly high.

Despite these factors, though, the outlook for the banking system is positive. Many large banks have increased their capital ratios this year, and this additional capital provides an important cushion against possible loan losses. As the economy continues to grow and expand, loan demand will likely become even stronger, and problems with nonperforming loans resulting from the latest recession should diminish significantly. Interest rates appear to have stabilized, and this factor, by eliminating the squeeze on banks' net interest margins, should significantly bolster earnings by the end of the year.

The recent problems of Continental Illinois National Bank are not reflective of the industry in general. The banking system as a whole remains strong and stable. Current economic conditions are very favorable for improved bank performance and increased earnings.

THE THRIFT INDUSTRY

Q: What is the outlook for the thrift industry's (savings and loan associations and mutual savings banks) earnings?

A: Now that interest rates have begun to decline again, the industry's earnings outlook has improved. Because of the increase in interest rates in the first half of 1984, which started to erode profit margins, the earnings for the total year 1984 will probably break even. The thrift industry's net worth (measured as general reserves and surpluses) showed a healthy 12 percent increase in 1983 when interest rates were slightly lower than they are now.

Traditionally, nearly all thrifts experience weak earnings when the interest cost of their relatively short-term liabilities is not matched by the yield of their long-term assets. As a result of lower interest rates, we expect profit margins at thrifts to widen and the positive earnings that will result will help to rebuild the industry's net worth position which was severely eroded in 1981 and 1982.

CURRENCY

Q: News reports indicate that the government is planning to redesign the currency. How can this boondoggle be justified by the same Administration that got elected by telling the American people that it was going to reduce the cost of government?

A: There is no boondoggle. The task force that Secretary Regan has appointed is addressing a real threat: the ability of counterfeiters to employ sophisticated high-technology to reproduce our currency. Copying machines with this capability will be on the market in the late 1980s. That's a threat to every American that we take very seriously.

The task force will report to the Secretary of the Treasury early in 1985. Changes in the design will be made only if it is absolutely necessary to protect our currency from criminals who threaten the security of our monetary system.

INDUSTRIAL POLICY

Q: Why don't we have an industrial policy?

A: We do not need an industrial policy to create jobs. Economic growth has created over 6 million jobs in the private sector in the last 21 months. That is almost 20 times the number of make-work public service jobs that government programs were spending $3 billion on in 1981.

As for industrial policy, that is a program to rearrange jobs, taking them from one area and putting them in another by government regulation or special tax loopholes. Government should not be trying to pick winners and losers among the country's businesses.

I guarantee you that government meddling would reduce the total job pool and waste billions of dollars. We want the economic pie to grow. We are not going to waste taxpayers' money trying to rearrange the slices.

SPOUSAL IRAs

Q: Recently Congress passed the Pay Equity Act of 1984, legislation sponsored by the Democratic Vice Presidential nominee Geraldine Ferraro. What is the Reagan Administration's record on providing economic equity for women?

A: President Reagan's record on economic equity for all Americans is clear. He believes that the greatest contribution his Administration can make to women is to keep the economy growing. But economic opportunity doesn't guarantee economic equity.

There are laws currently on the books to safeguard the rights of women. Those laws must be enforced; some must be strengthened.

Almost a year ago, President Reagan called for an end to the Democrats' demagoguery and recognition of that simple fact that all Americans are interested in the goal of ensuring legal and economic equity for women.

That's why at his news conference on July 24, the President called on Congress to enact in this session legislation granting women who work in the home the same individual retirement accounts (IRAs) as spouses working outside the home. Through this legislation, each spouse could save and deduct from taxation $2,000 each year. The House had a chance to enact this initiative in a bill the President signed in late July. They dropped the IRA language from the bill.

ENTERPRISE ZONES

Q: What is this Administration doing to stem the tide of poverty in urban America?

A: President Reagan has repeatedly asked Congress to enact a proposal offering incentives for investment to 75 enterprise zones to create jobs, independence and hope for people in inner cities and other economically distressed areas.

Despite Democratic promises of prosperity for every disadvantaged group in our society, they have repeatedly failed to follow through on their rhetoric. The Republican leadership in the House has attempted more than once to bring this legislation up for a vote, but to no avail.

TARGETED EUROBOND ISSUES

Q: Isn't the Treasury trying to finance the federal deficit on the backs of our Allies?

A: No. Foreign holdings of U.S. Treasury securities have, in fact, declined from 17% of total Treasury debt in 1978 to about 11% in 1984.

Most major foreign countries issue securities outside their domestic market, very often in bearer form, free of tax, in the Eurobond market. We are not issuing bearer bonds and will not be competing with them in that market.

We are simply taking advantage of the removal of a barrier to greater integration and efficiency in international capital markets, i.e., repeal of the 30 percent withholding tax on interest payments to foreigners.

The sum involved in the projected targeted borrowing, about $1 billion, is modest in the perspective of the $32 billion net capital inflow recorded by the U.S. last year. And the net capital inflow this year is expected to be much greater.

Thus, while we would expect the withholding tax removal to result in increased foreign purchases of Treasury securities, including the targeted issue, and reduced pressure on the domestic market for U.S. government securities, it is unlikely that the amounts involved would have a major impact on credit conditions abroad.